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SUBJECT: VIETNAM'S REGIONAL OVERVIEW: THE CENTER PLAYS CATCH-UP

REF: HCMC 921 (East-West Corridor)

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¶1. (U) Summary: Central Vietnam understands that it needs to improve its competitiveness or risk falling further behind the booming urban clusters of Hanoi and Ho Chi Minh City. A visit to three central provinces showed the difficulties in assembling the necessary components of a successful investment strategy. The slow flow of investment thus far, despite infrastructure development and incentives, has local authorities scratching their heads. There are encouraging signs that, at least in one of the provinces, the pace is picking up. End summary.

¶2. (U) Members of the economic sections of both the Embassy and the Consulate General are visiting various provinces to get a better picture of economic development through Vietnam. With this cable, we launch a series on Vietnam's provinces and regional competitiveness. From October 9 to 11, we traveled to the provinces of Quang Nam, Quang Tri and Thua Thien - Hue in central Vietnam to discuss the development and investment strategies at each place with regional government, NGOs and the private sector.

¶3. (U) Economic development in central Vietnam has historically lagged behind the north and south. As many leading indicators show, this is still the case. Poverty rates in the central region exceed 30%, and in the north-central region we visited, they are even higher. Average wages are almost half of the national average, and incomes a third lower. Almost a third of all the children in one of the provinces we visited suffer from malnutrition, according to an international NGO active in the area.

¶4. (U) Against this backdrop, there are positive signs. The provincial administrations, whose top leadership are appointed by Hanoi, are full of young reformers and technocrats. The central government and the Asian Development Bank have spent lavishly in an "East-West Corridor" that links ports in Central Vietnam to the road networks of Laos, Thailand and Burma (Reftel). Some central provinces have been inching up in the USAID-funded Provincial Competitiveness Index, including Danang, which received the second highest marks in the 2006 survey. (The 2007 Index is expected to be released on November 8.

ENTICING INVESTMENT: BUILD IT, BUT WILL THEY COME?

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¶5. (U) The three provinces we visited on this trip have pinned their hopes of drawing in investors with newly-built infrastructure projects and low-cost incentives. Thua Thien - Hue ("Hue"), for instance, touts the Chan May - Lang Co economic zone, which consists of 27,000 hectares of cheap land smack in the middle of the

East-West Corridor. Hue provides investors with a guaranteed low corporate tax rate of 10% for 15 years and taxes below the national rate of 29% for the following decade. The zone's managers claimed that at \$20 per square meter, their industrial land is about a fourth cheaper than their competitors' in the industrial areas around Ho Chi Minh City (HCMC). In addition, Hue's Chan May offers a new deep-water seaport, which is able to handle 30 ton-capacity ships (and in the near future up to 50 tons).

¶6. (U) Quang Nam and Quang Tri's economic zones offer even more competitive incentives. Quang Nam's Chu Lai and Quang Tri's Lao Bao do not charge for land at all during the first decade of operation, and cap rent for decades thereafter. After the first 10 years, Chu Lai applies a monthly rent of \$0.25 per square meter for the next 40 years; and after the first 11 years in Lao Bao, rent is fixed indefinitely at 30% of the average cost of rural land rentals in Quang Tri. Taxes are also capped, at 10% in Quang Nam for the first decade and a third of the national rate for the next 30 years. In Lao Bao, Quang Tri offers four years of tax exemption, followed by 9 years at 15%, and 10% indefinitely thereafter. All goods sold in Lao Bao are not subject to value-added tax and all imports can enter the zone duty-free. If the goods leave the zone and enter the rest of Vietnam, however, the tax and duty exemptions disappear.

¶7. (U) Hue and Quang Nam have fared much better at attracting investment than Quang Tri. The former two are already the sixth and tenth most successful provinces in the nation this year with \$553 million and \$207 million of registered investment, respectively. Quang Tri, on the other hand, trails all other provinces in the country with a paltry \$20,000 of investment in 2007, according to Vietnam's Office of General Statistics.

#### THE CHALLENGES

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¶8. (U) The three provinces face significant challenges, some common to all, others due to intrinsic conditions, and others of their own

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making. Quang Nam's industrial zone is built up and ready to go, but poor access roads and even worse port facilities choke off its access to the mainstream economy. Hue, which has roads and ports, has no budget to build up its own zone. Quang Tri expected to benefit from cross-border trade that never materialized.

#### TOO LITTLE OR TOO MUCH INFRASTRUCTURE

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¶9. (U) A recurrent problem we noticed was the lack of a good match between infrastructure supply and demand. Whereas Hue and Quang Tri had plenty of underutilized infrastructure, Quang Nam was in desperate need of good access to suitable ports. Despite having spent \$750 million to modernize its Vietnam war-era airport, it is still unable to accommodate anything larger than twin-engine propeller planes and none capable of transporting cargo. Quang Nam's port is another legacy from the war, lacking cranes or machinery, and unable to receive any ship over seven tons. Most exporters opt to ship out from the larger port of Danang, only 32 km away but accessible only by a congested and badly maintained one-lane road.

¶10. (SBU) Poor infrastructure planning also hinders investment. Hue, for example, began development on the housing and tourism parts of its Chan May Park around an aging industrial park that contains wood chip and paper factories. The park developers hoped that these notoriously polluting factories would somehow be persuaded to leave or switch to cleaner methods of production, and that "cleaner" industries would move in to replace them. So far, this wish for transformation has not happened.

¶11. (SBU) The park currently has little supporting infrastructure to offer prospective businesses and its managers could not articulate how they intended to attract better investors. As a result of expenditures on the non-industrial projects and because of limited funding, the construction budget for Chan May will run out by the end of 2007 with the industrial zone still lacking an electrical

grid or water system, or with the land not even cleared or leveled. The park managers told us that they would resort instead to finding investors to develop the industrial park's infrastructure.

¶12. (SBU) Another anomaly is that Hue and Quang Tri's brand-new roads, ports and real estate developments are, for the most part, underutilized. The Lao Bao East-West Corridor Gateway on the Quang Tri side of the border with Laos is virtually derelict, with a few mom-and-pop shops selling cheap household goods and fake watches taking up the space of what was once intended to become a burgeoning shopping center. The adjacent economic zone, which opened to much fanfare in 1999, has attracted only a handful of investors, mostly in the retail sector, and a boom in cross-border traffic has failed to materialize (merely 300 vehicles cross the border daily, from 150 in 1999).

¶13. (SBU) The port of Danang itself is operating under capacity. While it is a modern facility that can berth cargo vessels of up to 30,000 tons, its low volume increases the time it takes to fill a ship. A Danang seafood exporter, for example, prefers to make the two-day drive to the ports in HCMC, where his goods can get to Japan in six days, rather than wait the 13 days that it would take if he were to ship out of Danang. This does not bode well for Hue's hopes for the Chan May deep water port, just an hour north of Danang.

#### SKILLED LABOR: KEEPING AND LURING GRADUATES

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¶14. (U) Shortage of skilled labor is another common and persistent challenge to the central provinces. Hue has a leg up by virtue of being one of the country's foremost academic centers, with 2,000 university lecturers and 50,000 college students enrolled at its eight universities. Hue, however, has not been able to generate enough jobs or high-enough salaries to retain them. "Most of them go south," lamented a top official from Hue's Department of Foreign Affairs.

¶15. (U) Quang Nam has only one center of higher education for its 1.4 million people, while Quang Tri's 633,000 people have none at all. The head of Quang Tri's Planning and Investment department estimated that as many as half of all high school graduates leave the province in search of jobs or higher education. Thus, Quang Nam and Quang Tri face the additional challenge of having to lure their graduates back after they complete higher education elsewhere.

¶16. (U) Increased investment may help temper the flight of skilled labor. The General Director of an American electronics plant in Quang Nam, for example, told us that he had succeeded in hiring 35 local engineers and that he was confident that, as long as there were good jobs on offer, local professionals would prefer to stay close to home.

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#### GOVERNANCE: A CLEAR VISION HELPS

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¶17. (SBU) Despite its relative success in attracting investment this year, Hue seems to be having difficulties in figuring out how to maximize its competitiveness. The 2006 Competitiveness Index had Hue at the bottom half of almost all important categories, and its legal institutions and provincial government got some of the lowest marks among the central provinces. The provincial administrators we met were unable to discuss the province's investment strategies in detail and, when asked, were unable to identify what comparative advantages, if any, they had to offer. The managers of the Chan May park in Hue were equally at a loss to explain how they intended to attract investors. "Hue seems to be coasting, there isn't much thought going on," a national competitiveness expert told us.

¶18. (SBU) Quang Tri's government is equally stumped for ideas, but the officers we met were much realistic than their counterparts in Hue about their current predicament. "We need to enact further administrative reforms and create a more favorable investment climate," the head of the Planning and Investment Department told us. "But even that won't do it, we're simply not in a position right

now to attract FDI."

¶19. (SBU) Quang Nam, on the other hand, has shown more clarity and resourcefulness at exploiting its competitive advantages and making the best of the infrastructure hand that it has been dealt. Its local government and legal institutions ranked among the highest in the country in the 2006 Competitiveness Index, and Quang Nam came in as the country's 15th most competitive province (out of 64).

¶20. (SBU) Quang Nam's local authorities, for example, successfully pitched to an American manufacturer of high-value electronic components that does not rely on heavy cargo hauls. "The province's people convinced us that this was the right fit," the General Director of the American plant said, "and so far it has worked." He added that, despite its infrastructure shortcomings, Quang Nam offered a much better labor climate and investment terms than Thailand or HCMC, the two other locations his company had considered.

COMMENT

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¶21. (SBU) There is no quick fix for central Vietnam. A good infrastructure base is important, but evidently not as much as having a good sense of needs and priorities. Aptly led, Quang Nam appears to be on the right track. Hue's outstanding new port and roads, and its proximity to the boomtown of Danang may save the day, despite its leadership's apparent lack of vision. Whether rural and impoverished Quang Tri can keep up with its neighbors is more uncertain. Clearly, its strategies need rethinking -- but at the very least its government appears serious in trying to find a solution.

¶22. This report was coordinated with Ho Chi Minh City.

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